No. 941686 APR 14 1995

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

SGS CONTROL SERVICES, INC.,

Petitioner,

—v.—

INTERNATIONAL ORE & FERTILIZER CORP.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Whether the court of appeals abuses its discretion when, after rejecting the claim upon which the trial court's money judgment for plaintiff was based, it nevertheless affirms the judgment by substituting a different claim that had been dismissed by the trial judge and that plaintiff had waived on the appeal.

2. Whether maritime law incorporates the non-maritime law principle that where parties contract informally, an extreme disproportion between contract price and claimed damages indicates that the damages were not within the contemplation of the contracting parties.

LISTING OF PARTIES, PARENT COMPANIES AND SUBSIDIARIES

All parties to the proceeding in the court whose judgment is sought to be reviewed are named in the caption.

The parent corporation of SGS Control Services Inc. is SGS North America Inc., whose parent corporation is SGS-Societe Generale de Surveillance Holding, S.A., whose shares are publicly traded on the Swiss Bourse. SGS Control Services Inc. has two subsidiaries, Independent Cargo Services Inc. and Qualitest, S.A., neither of which is publicly traded.

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PRELIMINARY STATEMENT

The opinion of the United States Court of Appeals for the Second Circuit, together with the dissenting opinion, is reported at 38 F.3d 1279 and is reproduced at App. A-1. The opinions of the United States District Court for the Southern District of New York are reported at 743 F. Supp. 250 and 828 F. Supp. 1098 and are reproduced at App. A-50 and A-99, respectively. The unreported opinion of the district court denying a motion for a new trial is reproduced at App. A-132.

The judgment of the court of appeals sought to be reviewed was entered on October 24, 1994. The order of the court of appeals denying the petition for rehearing was entered on January 20, 1995, and is reproduced at App. A-18. The transcript of oral argument in the Court of Appeals on April 24, 1994 is reproduced at App. A-185.

Jurisdiction to review the judgment of the court of appeals by writ of certiorari is conferred on this Court by 28 U.S.C. § 1254.

This case involves a question of federal appellate procedure and a question of maritime law, but does not involve a constitutional provision, treaty, statute, ordinance or regulation.

STATEMENT OF THE CASE

This case is within the admiralty and maritime jurisdiction of the district court pursuant to 28 U.S.C. § 1333. This case arose out of a contract between defendant SGS Control Services Inc. ("SGS") and plaintiff International Ore & Fertilizer Corp. ("Interore") for the inspection by SGS of the holds of a vessel in navigable waters in the Port of Tampa, Florida.

The inspection was performed by SGS for a contractual fee of $150. Claiming that the inspection was improperly performed, plaintiff Interore sought to recover damages of

$2,400,000. Without deciding whether the contract had been breached, the district court dismissed Interore's contract claim because the claimed damages were not contemplated by the parties. However, the district court held that SGS had negligently reported the results of the inspection and held it liable in tort for $479,687.12.

On the appeal, Interore waived the contract claim and the parties contested only the tort claim. In its decision, the court of appeals rejected the tort claim. However, the court of appeals did not reverse. Instead, with one judge dissenting, it reinstated the waived contract claim, found that the contract had been breached (despite the trial court's failure to rule on the issue of breach), and affirmed the judgment.

The Facts of the Dispute

Interore, a subsidiary of Occidental Petroleum Corp., sells phosphate fertilizer products in the international market. SGS is a surveyor of marine cargoes and vessels.

In June 1991, Interore hired SGS to sample and test a bulk cargo of phosphate and, in conjunction therewith, to inspect and report on the condition of three holds of the M/V ADELINA, prior to loading.

SGS had previously performed this type of service many times for Interore and therefore the hiring was very informal. The contract was merely a one-page telex from Interore to SGS. The telex requested that SGS inspect holds 2, 3, and 5 prior to loading, and stated in relevant part:

> Pls act our behalf performing inspection, sampling and analysis. Pls issue flwg docs: 1) Cert of hold inspection, confirming vsls holds were clean, dry and suitable.

Although not set forth in the telex, the price of the hold inspection and report, in accordance with past practice, was $50 per hold or $150 for all three.

To perform the hold inspection, SGS hired a subcontractor, Captain Luard, who had previously performed numerous hold inspections in Tampa. Captain Luard boarded the ship on July 2, 1985 and inspected holds 2, 3 and 5, and hatch covers. Luard then completed a Certificate of Readiness, which stated, in relevant part: "Said cargo compartments and HATCH COVERS have been surveyed and found suitable to load a cargo of PHOSPHATE this time and date."

After Luard completed the Certificate of Readiness, the vessel loaded the cargo and left Tampa, bound for New Zealand.

Seven months prior to the Tampa inspection, the ADELINA had carried a cargo of barley. However, since that time, the holds had been freshly painted, and Luard had not seen grains of barley that apparently were still lodged in overhead support beams. During the voyage to New Zealand, some of the grains were shaken loose and fell on top of the cargo.

When the holds were opened, a New Zealand government inspector noted what he considered to be barley contamination. Interore's New Zealand buyer, East Coast Fertilizer Co., Ltd., then refused to unload the cargo and refused to pay Interore the $2,691,803.96 purchase price. To effect salvage, Interore transported the cargo to Antwerp, where it was sold.

Proceedings in the District Court

Interore sued SGS to recover its alleged loss of $2,400,000, by filing a four-claim complaint in the United States District Court for the Southern District of New York on September 2, 1987. Interore's first three claims alleged breach of warranty under the inspection contract, negligent performance of the contract, and breach of contract. Interore's fourth claim was for tortious misrepresentation as to the condition of the holds and hatches.

After a non-jury trial on liability issues, District Judge Charles H. Tenney rendered an opinion dated August 28, 1990 and reported at 743 F. Supp. 250. Judge Tenney held that Interore could not recover compensatory damages on the contract. Although he found that the parties contemplated that SGS would use workmanlike efforts, Judge Tenney declined to reach the issues of what such efforts would entail or whether there was a breach. 743 F. Supp. at 257. Instead he found that the disproportion between the $2,400,000 of damages sought and the $150 contract price, coupled with the informal dealings between the parties, indicated that the parties had not attempted to allocate all of the risks. *Id.* at 257-258. Therefore, he ruled, the Court was justified in allocating the risks fairly. *Id.* He concluded that "[a]ccordingly," Interore should not recover compensatory damages on the contract. *Id.* at 258.

Judge Tenney also ruled that Interore's negligence claim could not be asserted because the alleged negligence was not an independent tort separate from the contract. *Id.*

However, Judge Tenney found SGS liable on the fourth claim, for negligent misrepresentation. He ruled that the Certificate of Readiness contained a negligent misrepresentation in that the inspector negligently failed to report to the vessel's representative that there were areas in the holds that he had been unable to inspect. *Id.* at 259.

Judge Tenney also found that Interore had failed to alert SGS to the extremely strict standards in New Zealand regarding importation of vegetable matter. *Id.* at 260. Ruling that Interore and SGS were equally responsible for the loss, Judge Tenney held SGS liable for 50% of the damages resulting from contamination of the Tampa cargo. *Id.*

The issues relating to damages were then tried without a jury before Chief Magistrate Judge Nina Gershon. Her report, rendered on March 31, 1993, and reproduced at 828 F.Supp. 1098, 1105, found the total damages suffered from contami-

nation of the Tampa cargo to be $959,375.44, consisting primarily of the transshipment cost from New Zealand to Antwerp and other salvage expenses. She recommended that Interore receive a damage award of $479,687.72, plus prejudgment interest.

Judge Tenney then adopted and accepted the Chief Magistrate Judge's report and recommendations, in an opinion dated August 10, 1993, reported at 828 F. Supp. 1098.

An amended judgment in favor of Interore and against SGS, in the amount of $713,666.27, inclusive of prejudgment interest, was entered on September 15, 1993.

SGS filed a notice of appeal from the amended judgment and Interore filed a notice of cross-appeal from the amended judgment.

Proceedings in the Court of Appeals

In the court of appeals, the issues and arguments presented related only to Interore's tort claim. Interore intentionally did not assert the dismissed contract claims, and thereby waived them.

SGS's appellant's brief to the court of appeals argued that liability could not be founded in tort because the dispute was governed by contract.[1] In its answering brief as appellee, Interore argued that SGS's negligent misrepresentation breached a duty independent of the contract.

The Points in Interore's Brief as to SGS's appeal were the following:

"POINT I: THE DISTRICT COURT PROPERLY RULED SGS LIABLE FOR NEGLIGENT

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[1] SGS's brief also argued that the elements of negligent misrepresentation were not established, that damages had been improperly calculated and that the trial court had committed procedural error on the issue of proximate cause.

PERFORMANCE OF PROFESSIONAL SERVICES

POINT II: JUDGE TENNEY'S FINDINGS OF FACT WITH REGARD TO SGS'S NEGLIGENCE WERE NOT CLEARLY ERRONEOUS

POINT III: THE DISTRICT COURT PROPERLY REFUSED TO OFFSET THE SETTLEMENT BETWEEN INTERORE AND EAST COAST"

[Subheadings omitted.]

These Points correspond closely to the Statement of Issues Presented for Review set forth in Interore's brief for the cross-appeal.

On its cross-appeal, Interore argued only that Judge Tenney should not have limited SGS's liability for negligent misrepresentation to 50% of the damages.

The single Point in Interore's brief as to Interore's cross-appeal was the following:

"POINT I: INTERORE WAS NOT CONTRIBUTORILY NEGLIGENT"

[Subheadings omitted.]

This Point corresponds closely to the single issue as to the cross-appeal stated in the Statement of Issues Presented for Review set forth in Interore's Brief.

Interore's brief did not state any issue, argument, reasons or citations in support of the contract claims. SGS's reply brief addressed only the issues raised by Interore and did not argue the contract claims.

At the oral argument of the appeal, Interore again declined to argue the contract claims or to argue that the contract was breached. The transcript of the argument (App. 6) confirms that Interore's counsel confined their contentions to the neg-

ligent misrepresentation claim. Midway through Interore's oral presentation, the Court asked why Interore's counsel had not cross-appealed from the dismissal of its contract claims. App. A-225. Interore's counsel answered to the effect that they thought the Second Circuit opinions in *Sundance*[2] and *Vitol*[3], as well as Judge Tenney's opinion below, were controlling. App. A-226 (*Sundance* and *Vitol* are contract cases that had disallowed consequential damages that were disproportionately large in relation to the contract prices.) Interore's counsel never disputed or distinguished these precedents, although they were presented by the panel with a clear opportunity to do so.

The court of appeals affirmed the amended judgment on October 24, 1994. The panel rejected the tort claim on which the judgment had been based. However, with one judge dissenting, the panel adopted the breach of contract claim, which Interore had already waived on the appeal, and found that the contract had in fact been breached.

Although the panel found for Interore on its waived contract claim, the panel limited Interore's recovery to the amount of the amended judgment. The panel said that "there has been no cross-appeal from the district court's dismissal of the contract claim, and we therefore leave the smaller judgment in place." 38 F.3d at 1279. Since Interore had in fact cross-appealed from the amended judgment, the finding that it failed to cross-appeal from dismissal of the contract claim could only refer to Interore's failure to argue the contract claim in its brief or at oral argument.

Interore's failure was not, however, simply a failure to cross-appeal. Interore's failure to argue or otherwise present the breach of contract claim in its brief or at oral argument

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[2] *Sundance Cruises Corp v. American Bureau of Shipping*, 7 F.3d 1077 (2d Cir. 1993), *cert. denied*, 114 S.Ct. 1399 (1994).

[3] *Vitol Trading S.A. v. SGS Control Services*, 874 F.2d 76 (2d Cir. 1989).

was also a waiver. Interore had intentionally *not* sought to sustain the judgment on contract grounds. With an eye to the opinions in *Sundance* and *Vitol*, it deliberately sought to sustain the judgment only on tort grounds. It thereby waived the breach of contract claim.

On the merits of the contract claim, the panel rejected Judge Tenney's view that the consequential damages were not recoverable due to the extreme disproportion between the fee charged and the damages claimed. 38 F.3d at 1284-1285. The panel found that the purpose of the certificate was to guarantee the condition of the hold so as to insure the preservation of the cargo. *Id.* at 1285.

Judge Tenney had also expressly not decided what specifically the contract required and had not decided whether SGS had in fact performed in a workmanlike manner. Nevertheless, and despite Interore's failure to argue these issues in the court of appeals, the court of appeals held that SGS had breached the contract. *Id.* at 1286.

The dissenting member of the panel agreed with the majority that liability could not be founded in tort. *Id.* at 1287. He too addressed the breach of contract claim, notwithstanding Interore's waiver of that claim on the appeal. *Id.* However, the dissenting judge agreed with Judge Tenney that the disproportion between the $2,400,000 of damages sought and the $150 contract price, coupled with the informality of the parties' dealings, and prior Second Circuit precedents, required dismissal of the contract claims. *Id.* at 1287-1289.

On October 7, 1994, SGS petitioned for rehearing and suggested rehearing en banc. SGS argued, *inter alia*, that it was improper for the court of appeals to decide the breach of contract claim after Interore had waived it and to find a breach when the trial judge had not reached that issue. On January 20, 1995, the court of appeals denied rehearing, without opinion.

REASONS WHY CERTIORARI SHOULD BE GRANTED

Question 1: Abuse of Discretion of the Court of Appeals By Deciding Claims That Have Been Waived

Certiorari should be granted to clarify the standard under which in civil cases a court of appeals may decide a claim that the proponent of the claim has waived. The absence of a clear standard undermines the integrity of the federal appellate process.

The Court has recognized that a court may consider an issue antecedent to and ultimately dispositive of the dispute before it, even an issue the parties fail to identify and brief in that court. *United States National Bank of Oregon v. Independent Insurance Agents of America*, 113 S. Ct. 2173, 2178 (1993).

However, the Court has not yet clearly articulated the standard for determining when the exercise of that discretion is appropriate. In the absence of a clearly expressed standard, some court of appeals' judges, relying on *Independent Insurance Agents*, assume, as the court of appeals apparently did in the present case, that they have virtually unlimited authority to decide dispositive issues, whether or not presented by the parties. *See Williams-Guice v. Board of Education of Chicago*, 45 F.3d 161 (7th Cir. 1995); *Jackson v. Culinary School of Washington*, 27 F.3d 573, 583-584 (D.C. Cir. 1994); *Sweet Home Chapter v. Babbitt*, 30 F.3d 190, 193-194 (D.C. Cir. 1994) (Silberman, J., dissenting from denial of rehearing en banc).

The court of appeals in the present case affirmed the judgment based on a claim that had not been presented and clearly had been waived. None of the judges of the panel that decided the appeal furnished any reason why deciding this waived contract claim would be a proper exercise of the court's power.

To conform to other established principles of appellate practice and to prevent a major disruption of the appellate process, the Court should set clear standards as to how the court of appeals must exercise its discretion.

The need for a standard is suggested by the requirement of due process, because limitless discretion can deprive adversely affected litigants of a meaningful opportunity to be heard. *Cf. Boddie v. Connecticut*, 401 U.S. 371, 377-378 (1971) (due process requires meaningful opportunity to be heard absent countervailing state interest of overriding significance). In this case, SGS properly relied on Interore's waiver and, in accordance with F. R. App. P. 28(c), its reply brief addressed only the arguments in Interore's answering brief. Because it followed the rules, SGS did not have a meaningful opportunity to be heard in the court of appeals on what proved to be the determinative issues in the case.

The need for a standard is also suggested by *United States v. Olano*, 113 S. Ct. 1770 (1993), where the Court carefully circumscribed the power of the court of appeals to consider issues not timely raised in the District Court in criminal cases. It would make little sense to narrowly restrict the court of appeals' power to correct plain errors at trial if at the same time the court of appeals has limitless discretion to consider unpresented issues.

The need for a standard is also suggested by the well-settled rule that failure to identify or argue an issue in a party's initial brief is a waiver of that issue and a court of appeals will ordinarily not consider that issue on the appeal, absent manifest injustice. *See, e.g., Anderson v. Branen*, 27 F.3d 29, 30 (2d Cir. 1994); *United States v. Quiroz*, 22 F.3d 489, 490 (2d Cir. 1994); *United States v. Restrepo*, 986 F.2d 1462, 1463 (2d Cir. 1993); *Winston v. Children & Youth Services of Delaware Cty.*, 948 F.2d 1380, 1385 (3d Cir. 1991); *United States v. Bell*, 936 F.2d 337, 343 (7th Cir. 1991); *Rollins Environmental Services v. U.S. EPA*, 937 F.2d 649, 653 (D.C. Cir.

1991). It is not manifest injustice to enforce a waiver resulting from the intentional tactical decision of experienced counsel. *See Mellon Bank v. United Bank Corporation of New York*, 31 F.3d 113 (2d Cir. 1994); *Air et Chaleur, S.A. v. Janeway*, 757 F.2d 489, 492 (2d Cir. 1985).

The need for a standard is also suggested by the Federal Rules of Appellate Procedure. F. R. App. P. Rules 28(a) and (b) require parties to specify and brief the issues. F. R. App. P. Rule 2, the sole rule that permits suspension of the appellate rules, authorizes the courts to relieve litigants of the consequences of default only where manifest injustice would otherwise result. *See Notes of Advisory Committee on Appellate Rules, Note 2* (1967).

The Court's recent cases are unclear as to what the standard is for the exercise of discretion to decide unargued issues. Compare *Independent Insurance Agents* and *Arcadia, Ohio v. Ohio Power Co.*, 111 S. Ct. 415 (1990) with *Lebron v. National Railroad Passenger Corp.*, 115 S. Ct. 961 (1995) or *United States v. Williams*, 112 S. Ct. 1735 (1992).

For example, judges and litigants do not now know whether the factors present in *Independent Insurance Agents* are necessary, or sufficient, for the exercise of the appellate court's discretion. In *Independent Insurance Agents*, (a) the unpresented issue (whether 12 U.S.C. § 92 had been repealed) was implicit in the respondent's argument from the start; (b) the unpresented issue involved the existence or non-existence of an Act of Congress; and (c) the court of appeals had given the parties "ample opportunity" to address the issue. *See* 113 S. Ct. at 2178-2179. In *Arcadia* the unpresented issue was implicit, and the issue involved the scope of a federal statute in relation to orders of federal agencies. In *Lebron* and *Williams*, however, while the Court recognized its power to "review an issue not pressed, but passed upon by the lower court," it failed to indicate any standard for when the reviewing court's discretion may be properly exercised.

In the present case, none of the *Independent Insurance Agent* factors appeared. The issue presented did not involve the existence (or scope) of an Act of Congress. The waived contract claim was not implicit in or antecedent to the tort claim, but rather was a separate alternative to it. SGS was not given the opportunity to address or brief the issue in the court of appeals. And, unlike *Lebron* and *Williams*, in *Interore* the court of appeals decided the dispositive issue (that the contract had been breached), even though that issue had not been passed upon by the district court.

A limitless standard for the courts of appeals *sua sponte* to review waived claims creates an immense practical problem for the appellate bar, and ultimately for the appellate courts themselves.

Absent a clear standard for when, and how, the court of appeals may consider waived issues, prudent appellants will be compelled in their *initial briefs* to raise and argue a wide range of potentially dispositive issues and claims as to which they may already have prevailed in the lower court, whether or not their adversaries wish to appeal those matters.[4] This will transform the nature—and ultimately the size—of appellants' briefs. It will also do great violence to the orderly scheme of F. R. App. P. Rule 28 which requires the appellee to raise whatever alternate issues have not been raised by the appellant and then affords the appellant the opportunity of a reply to respond to those matters.

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[4] For example, a plaintiff might prevail in the district court on the defendant's motions to dismiss based on lack of personal jurisdiction, improper venue, statute of frauds, failure to comply with a discovery order and so forth, but might lose at trial on a decisive evidentiary issue. Under *Interore*, the plaintiff-appellant's brief apparently should raise and argue not merely the evidentiary issue, but also all these pre-trial issues, whether or not defendant-appellee wishes to raise them. Otherwise, as in *Interore*, the Court of Appeals might affirm on an alternative unargued ground without the appellant's having addressed it in that court.

If the courts of appeals are to have the discretion to consider waived issues, it is vitally important to the appellate process that the Court clarify the standard under which that discretion is to be exercised.

Question 2: Disproportionality of Price To Damages Under Maritime Law

Certiorari should be granted to decide whether maritime law incorporates the principle of non-maritime contract law that where parties contract informally, an extreme disproportion between the contract price and the amount of damages claimed for breach indicates that the damages were beyond the parties' contemplation and therefore are not recoverable (the "Disproportionality Principle"). Second Circuit cases conflict on this issue and continued uncertainty significantly affects the maritime service industry.

The Disproportionality Principle is well-established in non-maritime law. *See, e.g.*, Restatement of Contracts (Second), §351(3), comment f; *Vitol Trading, S.A. v. SGS Control Services*, 874 F.2d 76, 81 (2d Cir. 1989); *Evra Corp. v. Swiss Bank Corp.*, 673 F.2d 951, 956 (7th Cir.), *cert. denied*, 459 U.S. 1017 (1982); *Goodstein Construction Corp. v. City of New York*, 590 N.Y.S.2d 425, 490 (N.Y. 1992); *Perini Corp. v. Greate Bay Hotel & Casino, Inc.*, 610 A.2d 364 (N.J. 1992) (approving the principle but finding it inapplicable to the facts); *Glatt v. Bank of Kirkwood Plaza*, 383 N.W.2d 473, 484 (N.D. 1986); M. N. Kniffen, "A Newly Identified Contract Unconscionability: Unconscionability of Remedy," 63 Notre Dame L. Rev. 247 (1988); *but see Sovereign Chemical & Petroleum Products, Inc. v. Ameropan Oil Corp.*, 148 F.R.D. 208, 213 (N.D. Ill. 1992) (declining to adopt the principle under Illinois law). The Disproportionality Principle protects contracting parties from the unduly harsh consequences of a breach where the parties have not clearly agreed to assume liability. The Disproportionality Principle recognizes the commercial reality that a very low price is a strong indication that

the contracting party did not assume a potentially crushing contingent liability for damages where the contract is informal and is silent as to such liability.

As a result of the Disproportionality Principle, commercial parties in a non-maritime context may conduct their affairs informally and inexpensively, without undue risk.

In maritime cases, however, there is a conflict within the Second Circuit as to the availability of the Disproportionality Principle. *Compare Sundance Cruises Corp. v. American Bureau of Shipping*, 7 F.3d 1077 (2d. Cir 1993) (applying the principle), *cert. denied*, 114 S. Ct. 1399 (1994), *with* the court of appeals decision in the present case.

In *Sundance*, the court of appeals applied the Disproportionality Principle, in a dispute between sophisticated commercial maritime parties, to disallow damages that were approximately 3,200 times the contract price. 7 F.3d at 1084. However in *Interore*, the court of appeals refused to apply the Disproportionality Principle even though the claimed damages were 16,000 times the contract price. *See Interore*, 38 F.3d at 1288 (dissenting opinion). Moreover, the *Interore* court suggested that it would never apply the principle in this case no matter how disproportionate ("whatever the amount") the damages claimed might be. 38 F.3d at 1285.

If the Disproportionality Principle applies under maritime law, the benefits that flow from its use in a land-based case would flow from its use in a sea-based case. If, however, under *Interore*, maritime service companies, contracting on an informal basis, are to face potentially limitless claims for liability, the effect on the maritime service industry will be dramatic. Either the cost of maritime service contracts is likely to increase markedly, or maritime service companies are likely to suffer severe financial strains. In either case, both the providers of maritime services and the consumers of those services need to know whether the Disproportionality Principle applies in maritime cases.

CONCLUSION

For the foregoing reasons, petitioner respectfully prays for issuance of a writ of certiorari to the United States of Appeals for the Second Circuit.

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